Supreme Court, U.S.
FILED
MAY 30 1995
OFFICE OF THE CLERK

(4)

No. 94-1239

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1994

FULTON CORPORATION,

Petitioner,

v.

JANICE H. FAULKNER, SECRETARY OF REVENUE,

Respondent.

On Writ of Certiorari to the
Supreme Court of North Carolina

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether the North Carolina intangible personal property tax on the value of corporate stock owned by shareholders discriminates against interstate commerce in violation of the United States Constitution by taxing one hundred percent of the value of stock of corporations that do no business in North Carolina, but exempting from taxation the stock of corporations that do business only in North Carolina, and reducing the taxable value of the stock of other corporations proportionately as the amount of business done by the corporation in North Carolina increases.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner Fulton Corporation states that it has neither a corporate parent nor a corporate subsidiary.

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OPINIONS BELOW

The Opinion of the Supreme Court of North Carolina (Pet. App. 1a-17a) is reported at 338 N.C. 472, 450 S. E. 2d 728 (1994). That opinion reversed the decision of the North Carolina Court of Appeals (Pet. App. 18a-35a), reported at 110 N.C. App. 493, 430 S.E. 2d 494 (1993).

JURISDICTION

The Supreme Court of North Carolina issued its opinion on December 9, 1994 and the clerk entered the judgment and issued the mandate of that court on December 29, 1994. The petition for a writ of certiorari was filed on January 13, 1995, and was granted on April 17, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article 1, Section 8, clause 3 of the United States Constitution provides in relevant part:

> The Congress shall have Power To . . . regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes; . . . .

Pertinent portions of the North Carolina taxing statutes appear in the Appendix to this Brief at 1a et seq.

STATEMENT OF FACTS

A. Procedural Background. Fulton Corporation (herein referred to as "Taxpayer"), a corporation chartered and domiciled in North Carolina, sued the North Carolina Secretary of Revenue in the North Carolina Superior Court for refund of taxes paid on stocks for 1990 and for declaratory judgment and attorneys' fees under 42 U.S.C. §§ 1983 and 1988, in May of 1991. The complaint asserted that N.C. Gen. Stat. § 105-203 violates the

Commerce Clause of the United States Constitution insofar as the statute imposes a property tax on some or all of the value of corporate stocks owned by Taxpayer. Joint App. 3. The trial court granted the Secretary of Revenue's summary judgment motion and denied Taxpayer's.

The North Carolina Court of Appeals on 15 June 1993 filed its unanimous opinion reversing the trial court's decision on the merits and remanding the cause for entry of a judgment declaring the intangibles tax provision at issue to be in violation of the Commerce Clause. *Fulton Corp. v. Justus*, 110 N.C. App. 493; Pet. App. 18a-35a. The Court of Appeals did not order refund of the taxes paid because it made its determination of unconstitutionality prospective only to the 1994 tax year (the opinion was issued in mid 1993).[1] Taxpayer sought review of the denial of refund and also of the Court of Appeals' denial of attorneys fees Taxpayer had sought under 42 U.S.C. §1988; the Secretary of Revenue sought review on the merits.

The Supreme Court of North Carolina agreed to review all issues raised by both parties, but did not reach the Taxpayer's issues because it reversed the decision of

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[1] The Court of Appeals cited as its ground for denying retrospective refund relief *Swanson v. State of North Carolina*, 329 N.C. 576, 581, 407 S.E.2d 791, 793 (1991), *vacated and remanded*, 113 S. Ct. 3025 (1993), *on remand*, 335 N.C. 674, 441 S.E.2d 537 (1994) (entering judgment for State), *cert. denied*, 115 S. Ct. 662 (1994). The Court of Appeals also selected as the prospective remedy to excise the deduction from N.C. Gen. Stat. § 105-203, relying on N.C. Gen. Stat. § 105-215. App. 12a.

the Court of Appeals on the merits, reinstating the decision of the Superior Court, and ruling that the North Carolina intangibles tax on stock does not violate the Commerce Clause. *Fulton Corp. v. Justus*, 338 N.C. 472; Pet. App. 1a-17a.

B. North Carolina Intangibles Tax Scheme. North Carolina imposes a property tax on the fair market value of certain financial intangibles, including corporate stock, owned by residents or arising from a non-resident's business in the State. N.C. Gen. Stat. §§ 105-203, 105-206; App. 9a, 10a. The tax is not imposed uniformly on the full fair market value of all stocks. Instead, the owners of the stock of certain corporations can deduct from the full value a percentage thereof, up to and including one hundred percent. [In this brief "corporation" refers to the corporation that issued the stock that is subject to the intangibles tax, and not to Fulton Corporation, which is referred to as "Taxpayer."]

The deduction is one hundred percent if one hundred percent of the business activities of a domestic corporation occurred within North Carolina in a specified earlier year. N.C. Gen. Stat. §§ 105-203(1), 105-130.7(1), 105-130.4; App. 9a, 8a, 1a. Examples would include incorporated purely local businesses such as corner drugstores, professional associations and the like. The stock of such corporations is free of intangibles tax.

No deduction from the full fair market value of the stock is allowed if the corporation is a foreign corporation that did no business in North Carolina in the specified earlier year. In addition to statutes cited in the preceding paragraph, *see* N.C. Gen. Stat. § 105-130.3 (under which

such a corporation is not subject to the state's corporate income tax); App. 1a. Examples are large national corporations such as Exxon Corp., GTE Corp. and Raytheon Corp. "Stock and Bond Values as of December 31, 1990" in Exhibit Notebook that is part of the Record on Appeal in the North Carolina Court of Appeals, 5 (footnote), 25, 29, 66.

In other cases the deduction is a percentage of the stock's value equal to the percentage indirectly determined by comparing the corporation's business activities in North Carolina with all of its business activities. Corporations in this latter category can be referred to as multistate corporations that do business in North Carolina. *See* N.C. Gen. Stat. § 105-130.4(b); App. 1a. While this group includes domestic North Carolina corporations that do some business outside the State, most commonly it includes large national corporations that do a small amount of business in the State, such as General Electric (1%) and IBM (5%). "Stock and Bond Values as of December 31, 1990," 30, 39.

The statute quantifies the percentage of a multistate corporation's business activities in North Carolina by use of the allocation and apportionment rules in the North Carolina corporate income tax. N.C. Gen. Stat. § 105-203(1), § 105-130.7(1), § 105-130.4; App. 9a, 8a, 1a. The allocation rules allocate to North Carolina all of the domestic corporation's nonbusiness income from certain passive investments (for example, interest and dividends received by a corporation whose commercial domicile is in North Carolina, and rents received from property located in North Carolina). N.C. Gen. Stat. § 105-130.4(c) - (h); App. 1a. The apportionment rules apportion to North

Carolina that part of a corporation's business income deemed earned in the State, determined by dividing each of its payroll, property and sales volume "factors" within the state by the totals thereof and averaging the three percentages, with the sales factor being double weighted. N.C. Gen. Stat. § 105-130.4(i) - (l); App. 4a - 8a.

In practice, shareholders determine their intangibles tax bases by multiplying the full value of their stock in a corporation by the corporation's "taxable percentage," which the Secretary of Revenue determines and publishes annually for a large number of corporations. For example, the taxable percentage for 1990 for General Electric was 99% and for IBM was 95%. "Stock and Bond Values as of December 31, 1990," 30, 39. See also "1990 Taxable Percentages," containing similar information for other stocks.

C. Application of the Intangibles Tax to Taxpayer. The North Carolina intangibles tax applied as follows to the stocks owned by Taxpayer on December 31, 1990. Most of Taxpayer's stocks were "100% taxable." Joint App. 11. This means that the corporations were neither domiciled in North Carolina nor did business in or earned income from North Carolina (and so were not subject to the North Carolina corporate income tax). Taxpayer was charged intangibles tax on 100% of the market value on December 31, 1990 of the stocks of such corporations. Taxpayer owned stock of one corporation that did part of its business in North Carolina, Food Lion, Inc. Its stock's taxable percentage was 54%, meaning that 46% of Food Lion's business was done in North Carolina (and 46% of its net income was subject to the North Carolina corporate income tax). Joint App. 11; Record on Appeal in North Carolina Court of Appeals 17).

D. Proceedings Below. The North Carolina Court of Appeals ruled that the intangibles tax on stock facially discriminates against interstate commerce because "shareholders of out-of-state corporations are required to pay intangibles taxes on a higher percentage of shares [values] than shareholders of corporations operating solely in North Carolina." 110 N.C. App. at 499; Pet. App. 25a. The Court of Appeals recognized the applicability and violation of this Court's internal consistency test for Commerce Clause violations, which asks whether the state's tax regime, if adopted by all states, would necessarily result in discrimination against interstate commerce. The Court of Appeals rejected the Secretary of Revenue's argument that the property tax imposed on stock was a "compensating tax" designed to make interstate commerce bear a burden already borne by intrastate commerce in the form of the corporate income tax.

Finally, the Court of Appeals distinguished the 1912 decision of this Court in *Darnell* because it involved a property tax on stock that treated the stock as embodying the corporate property, which also was subject to the state's property tax; the Court of Appeals found no similar effort by North Carolina to tax property value once. *Darnell v. Indiana*, 226 U.S. 390 (1912).

On appeal from the Court of Appeals, the Supreme Court of North Carolina did not dispute the facial discrimination of the North Carolina intangibles tax, but found that the *Darnell* decision controlled and

furthermore that *Darnell* compelled it to accept the Secretary's compensating tax defense to the facial discrimination. The Supreme Court of North Carolina ignored this Court's internal consistency test and the discrimination it illustrates.

E. Subsequent Event. Subsequent to this Court's grant of its writ of certiorari, the North Carolina General Assembly repealed the intangibles tax for returns due in 1996. 1995 N.C. Sess. Laws Ch. 41; App. 15a. This repeal does not affect the tax year at issue in this case or Taxpayer's refund claim, which remain unsatisfied (as do the refund claims of the Taxpayer for other years for which a separate suit has been brought, and the refund claims of thousands of similarly situated North Carolina taxpayers for 1991, 1992, 1993 and 1994 taxes). Taxpayer made its refund claim under N.C. Gen. Stat. § 105-267, the only avenue allowed by the North Carolina courts for a taxpayer to contest an illegal tax. App. 14a. Therefore, the case is neither moot nor is the importance of the legal issues upon which this Court issued its writ of certiorari diminished.[2]

[2] The case is not moot so long as the parties have a concrete interest in the outcome of the action, however small. *See University of Texas v. Camenisch*, 451 U.S. 390 (1981); *Powell v. McCormack*, 395 U.S. 486, 495-500 (1969); *Ellis v. Brotherhood of Clerks*, 466 U.S. 435 (1984) (not moot where claim for damages remained); *Board of Pardons v. Allen*, 482 U.S. 369, 370 n. 1 (1987) (remaining claims for damages prevented mootness). Furthermore, the significance of the issue on which this Court granted its writ continues. The instant case is distinguishable from perhaps the classic case in which this Court discussed dismissal of a previously granted writ, wherein the state adopted a statute that precluded any future enforcement of the offensive cemetery contract terms at issue in the case, so that similarly situated plaintiffs in any other case arising in the future would be entitled to damages. *Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70 (1955). Here Fulton Corp. and other North Carolina taxpayers have pursued and can pursue refund of these illegal taxes and have been and will be denied those refunds on the basis of the decision of the Supreme Court of North Carolina in the instant case.

The Supreme Court of North Carolina did not reach the erroneous conclusion of the North Carolina Court of Appeals that its determination of unconstitutionality was prospective only, which permitted the Court of Appeals to deny the Taxpayer's demand for refund. Taxpayer assumes that remedial issues will be decided by the North Carolina Supreme Court on remand from this Court, unless this Court directs their resolution on its own motion.[3]

SUMMARY OF ARGUMENT

A. A state tax that facially discriminates against interstate commerce is presumptively invalid under the Commerce Clause.

[3] *Cf. Swanson v. State of North Carolina*, 329 N.C. 576, 581, 407 S.E. 2d 791, 793 (1991), *vacated and remanded*, 113 S. Ct. 3025 (1993), *on remand*, 335 N.C. 674 (1994) (entering judgment for State), *cert. denied*, 115 S. Ct. 662 (1994) (illustrating the difficulties the North Carolina courts have imposed in the way of refunds of taxes ruled unconstitutional by this Court). *See also* N.C. Gen. Stat. § 105-216, App. 13a, which exacerbates the difficulties here by providing that the intangibles tax will revert to being a local tax if held illegal at the state level.

B. N.C. Gen. Stat. §105-203(1) facially discriminates against interstate commerce by reducing the tax base of the intangibles tax on stock by a percentage of the stock value equaling the percentage of the corporation's income that is subject to income tax in North Carolina. That discrimination disfavors interstate commerce and favors local commerce because the percentage of deduction increases with an increase in the amount of business and contacts of the corporation with North Carolina.

C. The facial discrimination cannot be overcome by a compensating tax defense, based on *Darnell v. Indiana*, or otherwise. The intangible tax either discriminates against interstate commerce, or unconstitutionally attempts to tax income the corporation earns outside of North Carolina, or both.

1. The Supreme Court of North Carolina incorrectly determined that the application of the compensating tax defense was controlled by *Darnell v. Indiana*, 226 U.S. 390. That case is factually distinguishable in that it involved an Indiana property tax on 100% of the value of stock, which was applied to stock of an Indiana corporation by allowing the shareholder an offset against taxable stock value in the amount of the value of the corporate property taxed in Indiana.

In contrast, the instant case involves North Carolina property tax on a percentage of the value of corporate stock which percentage decreases as the percentage of the corporation's *income* that is taxed in North Carolina increases. In effect, the North Carolina stock tax is not imposed on property but rather is imposed indirectly on the part of the corporate income that North Carolina is not constitutionally entitled to tax because it is earned out of the State.

2. Moreover, *Darnell* did not involve a successful compensatory tax defense. It simply involved a stock tax with an offset. There was no intrastate burden for which the stock tax compensated because all property of foreign and domestic corporations that was subject to property tax in Indiana was taxed by Indiana.

3. In any event, the North Carolina scheme fails each of the three requirements of the compensatory tax defense. First, the tax on stock does not compensate for any burden borne by intrastate commerce that interstate commerce *improperly* avoids. Moreover, the compensating tax defense requires substantial equality of taxation of the local and interstate commerce, based on a comparison of equivalent tax bases and equivalent rates. Here there are neither comparable tax bases nor equivalent rates and the taxes do not fall on substantially equivalent events.

D. The North Carolina scheme for taxing stock values and corporate income (which are caused to be interrelated by statute) fails the internal consistency test, even if the intangibles tax could be a compensatory tax.

1. This Court requires that even a taxing scheme that appears to involve equivalent compensating taxes be tested for internal consistency under the Commerce Clause. Internal consistency requires that the application of the North Carolina taxing scheme by all states would not necessarily produce multiple taxation of

or on account of interstate commerce as compared with local commerce.

2. The North Carolina scheme of intangibles and corporate income taxation, if applied by all states, would result in corporations paying tax on about 100% of their incomes in the aggregate to all states in which they do business, and shareholders paying zero intangibles tax if they reside in the same state with their corporation that does business only in that state; but to any extent that the shareholders reside in a state where the corporation does not do all of its business, some intangibles tax will be due. Thus more aggregate tax is due on account of shareholding across state lines, or on account of the corporation doing business in interstate commerce.

3. Although *Darnell* may be distinguished rather than overruled, the tax scheme there at issue also failed the internal consistency test by taxing more heavily the shareholders of multi-state corporations.

ARGUMENT

THE FACIALLY DISCRIMINATORY INTANGIBLES TAX ON STOCK VIOLATES THE COMMERCE CLAUSE.

A. State Tax Laws That Discriminate Against Interstate Commerce on Their Face Are Presumptively Invalid Under the Commerce Clause.

Discrimination against interstate commerce both is forbidden by one part of the four part test for compliance of state taxes with the Commerce Clause articulated by *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, *reh'g denied*, 430 U.S. 976 (1977) (the other parts requiring substantial nexus of the taxpayer with the taxing state, fair apportionment of taxes and fair relationship of taxes to the services provided by the state), and continues to be viewed by this Court as the evil at which the Commerce Clause is generally aimed. *See Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984) (grounding the decision on discrimination against interstate commerce and not the four part *Complete Auto* test); *Welton v. Missouri*, 91 U.S. 275 (1876) (one of the earliest Commerce Clause cases, invalidating as discriminatory a license fee imposed on peddlers of out-of-state goods).

Such discrimination exists when the state tax statute treats a transaction differently because of some interstate element. *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 332 n.12 (1977). "That is, a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state." *Armco Inc. v. Hardesty*, 467 U.S. at 642. This Court has recently summarized the definition of discrimination in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. 1331, 1344-1345 (1995) to include providing a direct commercial advantage to local business so as to discriminate against foreign enterprises that might compete with local businesses, and discriminating against commercial activity occurring outside the taxing state. *See also Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984) (stating that a tax scheme should not foreclose "tax-neutral decisions. . . ."; finding

discrimination in limitation of a tax credit to receipts from shipment only from New York).

Facial discrimination against interstate commerce by a taxing statute is sufficient to void a statute under the Commerce Clause. *Memphis Steam Laundry Cleaners, Inc. v. Stone*, 342 U.S. 389, 395 (1952) (stating that a state tax statute is constitutional only if "no discrimination against interstate commerce appears either upon the face of the tax laws or in their practical operation."); *Armco Inc. v. Hardesty*, 467 U.S. at 642 (finding to be facially discriminatory differential taxation depending on whether the taxpayer conducts manufacturing in or out of the state); *Associated Indus. of Mo. v. Lohman*, 114 S. Ct. 1815, 1820 (1994) ("we ... have applied a 'virtually *per se* rule of invalidity' to provisions that patently discriminate against interstate trade"). *Cf. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue*, 112 S.Ct. 2365, 2368 (1992) (stating in analogous "foreign commerce clause" case that the test is also facial discrimination).

Where facial discrimination exists, proof of discriminatory effect or impact is not required, in contrast with cases where there is no facial discrimination but the taxpayer attempts to prove discrimination in practical operation of a statute. *See Memphis Steam Laundry Cleaners, Inc. v. Stone*, 342 U.S. at 395 (identifying this alternative way to prove discrimination); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940) (finding tendency to discriminate in the practical effects of a facially nondiscriminatory North Carolina tax, but without requiring any proof of actual discrimination); *Armco Inc. v. Hardesty*, 467 U.S. at 644 (analogizing the fair

apportionment test to the nondiscrimination test in terms of not requiring the taxpayer to prove actual discriminatory impact).

Furthermore, there is no requirement that a state, its legislature, or responsible officials have the intent to harm interstate commerce in order for a facially discriminatory state tax to be voided under the Commerce Clause. *Associated Indus. of Mo. v. Lohman*, 114 S. Ct. at 1824; *James B. Hunt, Jr. v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 352 (1977) ("we need not ascribe an economic protection motive to the North Carolina Legislature to resolve this case; . . .").

Accordingly, a state taxing statute is presumptively invalid when by its terms it imposes relatively heavier taxation on account of interstate elements.

B. The North Carolina Intangibles Tax Facially Discriminates Against Interstate Commerce.

N.C. Gen. Stat. §105-203(1), App. 9a, facially discriminates against interstate commerce by *only* taxing the stock of corporations that either engage in interstate commerce or do no business in North Carolina.

It accomplishes this result by allowing a deduction from full value in computing the taxable stock value base. That deduction increases as the North Carolina business activities and contacts of the corporation increase (North Carolina employees, property, sales, commercial domicile, etc.); the deduction decreases as those local contacts and business decrease. Thus, the value of stocks of more "local" corporations that engage less in interstate

commerce is taxed more lightly than the value of stocks of more "national" corporations that engage more in interstate commerce. The stock tax thus discriminates against interstate commerce of the corporation, against interstate commerce in the stock of those corporations, against shareholders who own corporations that engage, and engage more, in interstate commerce, and against such corporations.[4]

This facial discrimination is analogous to discrimination found in *Armco Inc. v. Hardesty*, 467 U.S. 638 and *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 240 (1987) where facial discrimination occurred in the exemptions of taxpayers from one tax because the taxpayers were subject to

[4] While not necessary to a determination of facial discrimination, observe that the North Carolina tax scheme has the tendency to encourage North Carolina investors to buy stock in local corporations (such as Carolina Power and Light, Duke Power, Jefferson Pilot, etc., which are listed in the "Stock and Bond Values" exhibit as taxable 30%, 16%, and 1% respectively), rather than in corporations with more multistate activity, because the local stocks are taxed less or not at all. This has a tendency to affect the ability of out-of-state corporations to raise capital in interstate commerce by lessening the attractiveness of such stocks to buyers in this State. *See* Affidavit of Robert Gibbs Smith; Joint App. 13. In addition, the taxing scheme has the tendency to discourage local corporations from entering interstate commerce, which action would result in a higher percentage of their stocks' value being subject to the intangibles tax on their North Carolina shareholders, without reducing the corporation's nationwide income tax exposure.

another tax based on the taxpayers' activity in the state.[5] It also has the same tendency as the facially discriminatory Severance Tax Credits in *Maryland v. Louisiana*, 451 U.S. 725, 757 (1981), to encourage North Carolina corporations to invest in North Carolina business rather than to invest in business in other states. *See also, American Trucking Ass'ns. Inc. v. Scheiner*, 483 U.S. 266, 286-287 (1987) (stating that a disparate tax burden "has a forbidden impact on interstate commerce because it exerts an inexorable hydraulic pressure on interstate commerce to ply their trade within the State that enacted the measure rather than 'among the several States.' U.S. Const., Art. 1, §8, cl. 3.").

North Carolina could have avoided the discrimination either by not allowing a deduction based on the corporation's North Carolina income tax (and thus taxing 100% of the value of all stock) or by not taxing stock value, which in effect would approximate allowing a deduction for the percentage of the corporation's income taxed nationwide (*i.e.*, 100%).[6]

[5] *See Armco*, 467 U.S. at 642 (quoting Justice Goldberg's dissent in *General Motors Corp. v. Washington* as source for this view of facial discrimination).

[6] *Cf. Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. at 1342 n. 6 (stating that a state need not credit sales tax paid by buyer against gross receipts tax paid by seller, but if it chose to do so for taxes paid to that state, it must extend credit to sales tax paid to other states).

C. The Facial Discrimination Cannot Be Overcome By A Compensating Tax Defense.

The North Carolina Supreme Court based its rejection of the Commerce Clause's application entirely on the Secretary's argument that the intangibles stock tax is a compensating tax for the corporate income tax, allegedly removing in effect the facial discrimination in the intangibles tax, relying on *Darnell v. Indiana*, 226 U.S. 390. The North Carolina Supreme Court argued that the intangibles tax is a proper compensating tax for the income tax that North Carolina imposes on corporations, because the income tax cannot reach corporations that do no business in North Carolina, or the income from the part of the business done outside North Carolina. Pet. App. 11a. North Carolina, however, has no right to be compensated for that income tax.

A facially discriminatory tax can be consistent with the Commerce Clause if it is designed simply to make interstate commerce bear an appropriate burden already borne by intrastate commerce. *See Associated Indus. of Mo. v. Lohman*, 114 S. Ct. at 1821. There is no evidence that the taxing regime at issue here is based on any such design.[7]

The classic example of a compensating tax is the use tax, which imposes on the purchase price of goods purchased in interstate commerce the same rate of tax that the sales tax imposes only with respect to the purchase price of locally purchased goods. The use tax appears to

[7]See deposition of Frank Goodrum, Jr. pp. 28-29 (disavowing the existence of any expressed aim of the statutory scheme).

discriminate against interstate commerce because it is limited to goods that have been brought or moved in interstate commerce. However, the sales tax corrects in effect the facial discrimination of the use tax by imposing an equivalent tax on the goods bought in the state. *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937); *Oregon Waste Sys., Inc. v. Dep't of Env. Quality*, 114 S. Ct. 1345, 1353 (1994) (stating that the only successful use of the compensating tax defense in recent memory is the case of the sales and use taxes). Each of the sales and use taxes are appropriately levied because each taxes consumption of the goods in the state, deemed to occur upon delivery within the state or use in the state.

1. *Darnell* is not controlling.

The Supreme Court of North Carolina felt bound by *Darnell*. That decision, however, is factually distinguishable. It involved a tax on stock value imposed on shareholders of domestic Indiana corporations, with a reduction in the tax base dollar-for-dollar as the domestic corporation's property tax base in the State increased. Shareholders of foreign corporations paid property tax on 100% of the value of their stock whether or not the corporation owned property in Indiana. Mr. Darnell owned stock of a Tennessee corporation that did not have property located in Indiana. The *Darnell* opinion strongly indicated that the Indiana statute was discriminatory because it failed to allow a similar reduction for property of foreign corporations taxed in Indiana, but did not have

to resolve that issue as it was not presented by the facts of the case.[8]

Thus, *Darnell* principally stands for the proposition that the shareholder's state of residence can tax 100% of the value of stock owned. *See First Bank Stock Corp. v. State of Minnesota,* 301 U.S. 234, 240 (1937) (citing *Darnell* for power of state of shareholder's residence to tax stock value). That tax used a prepayment of the shareholder level tax by the corporation.

Darnell is not controlling because North Carolina's tax scheme substantially differs from that Indiana scheme. The North Carolina taxing statutes make no effort to tax only once the value of stock. Instead, it interrelates the corporate income tax and the shareholder's property tax in a discriminatory fashion, as illustrated above.

2. Moreover, *Darnell* did not involve a successful compensatory tax defense.

The Supreme Court of North Carolina viewed *Darnell* as involving a successful compensatory tax defense. Pet. App. 11a. This is incorrect. This Court has

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[8] Justice Holmes stated: "The most serious aspect of this objection is that the statutes of Indiana do not make allowances if a foreign corporation has property taxed within the state. But, as to this, it is enough to say that, however the statutes may be construed in a case of that sort, the plaintiffs in error do not show that it is theirs, and that, as they do not belong to the class for whose sake the constitutional protection would be given, if it would, they cannot complain on that ground." 226 U.S. at 398.

never cited the *Darnell* case as a compensatory tax case. *See also* Walter Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 Tax Law. 405 (1986) (containing an exhaustive study of compensating tax doctrine, but not citing *Darnell*). The defense is superficially similar to *Darnell's* facts in that they both involve an interrelationship between two taxes, but *Darnell* simply used the corporate property tax as a prepayment of the shareholder's property tax. *Cf. Maryland v. Louisiana,* 451 U.S. at 759 ("Of course, it [the Louisiana First Use Tax] does equalize the tax burdens on OCS gas leaving the State and Louisiana gas going into the interstate market. But this sort of equalization is not the kind of 'compensatory' effect that our cases have recognized.")

Darnell could not involve a compensatory tax because it did not satisfy the threshold requirement of the compensatory tax analysis, discussed in section 3 below: that there be an intrastate tax burden borne by intrastate commerce that the state is entitled to impose on interstate commerce by way of the compensating tax. Indiana was not taxing the stock of foreign corporations because it needed a way to tax the out-of-state property of foreign corporations. Rather, it was taxing 100% of all stock of residents because it had the power to do so, and it allowed a credit or prepayment of taxes paid by a related party - the domestic corporation - and should have allowed a credit for Indiana property tax paid by a foreign corporation.[9]

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[9] See footnote 8, *supra*.

3. The North Carolina scheme fails each step of the compensatory tax analysis.

Oregon Waste Sys., Inc. v. Dep't of Env. Quality, 114 S. Ct. at 1352, set forth the three steps required to prove a compensatory tax defense. First, the state must identify the burden on intrastate commerce that is being *improperly* avoided by interstate commerce: ". . . as a threshold matter, 'identif[y] . . . the [intrastate tax] burden for which the State is attempting to compensate.'" 114 S. Ct. at 1352. Second, the compensatory tax and the intrastate tax must be equivalent. Third, the two taxes must fall on substantially equivalent events. *See also Associated Indus. of Mo. v. Lohman*, 114 S.Ct. at 1821 (also outlining the three step analysis).

The Supreme Court of North Carolina found the shareholder's property tax to compensate for the inability of the State to tax the income of the corporation earned out-of-state. Pet. App. 11a. But North Carolina has no right to tax the corporate income earned out-of-state. There is here no tax that the in-stater is paying but the out-of-stater is not paying for which compensation is needed. This Court made essentially the same observation in *Maryland v. Louisiana:*

> In our view, the First-Use tax cannot be justified as a compensatory tax. The concept of a compensatory tax first requires identification of a burden for which the State is attempting to compensate. Here, Louisiana claims that the First-Use tax compensates for the effect of the State's severance tax on local production of natural gas. To be sure, Louisiana has an interest in protecting its natural resources, and, like most states, has chosen to impose a severance tax on the privilege of receiving resources from its soil. . . . *But, the First-Use tax is not designed to meet these same ends since Louisiana has no sovereign interest in being compensated for the severance of resources from federally owned OCS land.* [emphasis added]

Maryland v. Louisiana, 451 U.S. at 759.

In contrast, the properly compensatory sales and use taxes are both imposed on an event that the state has the power to tax: the use or consumption in the state of the property, irrespective of whether it is acquired within the state or from another state. *Associated Industries* stated:

> Cf. *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 66, 83 S.Ct. 1201, 1202, 10 L. Ed. 2d 202 (1963) ("[T]he purpose of such a sales-use tax scheme is to make all tangible property used or consumed in the State subject to a uniform tax burden irrespective of whether it is acquired within the State . . . or from without the State").

Associated Indus. of Mo. v. Lohman, 114 S.Ct. at 1821.

Maryland v. Louisiana also made this point by focusing on the consumption in the state, which is the jurisdictional nexus for both the sales and use tax:

> . . . the two events [the severance of oil from Louisiana lands and the severance of oil from federally owned OCS land] are not comparable in

> the same fashion as a use tax complements a sales tax. In that case, a state is attempting to impose a tax on a substantially equivalent event to assure uniform treatment of goods and materials *to be consumed in the state*. No such equality exists in this instance. [emphasis added]

Maryland v. Louisiana, 451 U.S. at 759.

See also Henneford v. Silas Mason Co., 300 U.S. 577, 584 (1937) ("No one who uses property in Washington after buying it at retail is to be exempt from a tax upon the privilege of enjoyment except to the extent that he has paid a use or sales tax somewhere."); *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. at 1343 (identifying local activity as basis for taxing power and stating that a credit against the use tax would be required for sales tax paid to another state on the same goods).

Even if somehow the intangibles and corporate income taxes could be viewed as possibly compensatory, there is no sort of equivalence between the two taxes, and so the second and third requirements for a compensating tax also are lacking. While the income of a corporation may or may not bear some relationship to its stock value, that does not prove that taxing one corporation's income results in equal treatment (*i.e.*, the same total taxation) with taxing another corporation's shareholders on their stock.

This Court has recently discussed the practical implementation of the compensating tax defense in *Associated Indus. of Mo. v. Lohman*, 114 S. Ct. 1815. It rejected Missouri's asserted compensating tax defense

because any equivalence of sales and use tax "is a matter of fortuity, ... " that did not comply with the "strict rule of equality adopted in *Silas Mason*." 114 S. Ct. at 1821. Even though the differential in sales and use taxes in Missouri was in many cases quite small, this Court applied its view that "the magnitude and scope of the discrimination have no bearing on the determinative question whether discrimination has occurred." 114 S. Ct. at 1822.

Furthermore, this Court distinguished as "bypassed by later decisions" an earlier decision that upheld a tax even though it did not tax in and out-of-state commerce with mathematical exactness; that is, " 'close enough for government work' . . . never took root in our Commerce Clause jurisprudence" but instead, the "strict rule of equality . . . has controlled compensatory tax cases for over half a century." 114 S. Ct. at 1823. This Court required that the tax on the intra and interstate transaction be in "the *same amount*." 114 S. Ct. at 1823.

The *Associated Industries* opinion made another pertinent point, stating that courts should not "plunge . . . into the morass of weighing comparative tax burdens," but rather should normally limit themselves to looking for equivalent rates on substantially equivalent events and not be "drawn into an amorphous inquiry that involves balancing incommensurate burdens imposed on disparate activities throughout the complex structure of a State's tax system." 114 S. Ct. at 1825 n. 5. The opinion of the Supreme Court of North Carolina plunges into exactly that sort of morass. Its offer of proof (which was not argued by the Secretary) involved the truism that given a top North Carolina corporate income tax rate of 7.75% and an

intangibles tax rate of 25 cents per hundred dollars of stock value, a corporation would have to have a price/earnings ratio in excess of 31 for the intangibles tax to exceed the corporate income tax. Pet. App. 13a-14a.

This observation entirely misses the point. Under the North Carolina Supreme Court's example, the Virginia corporation doing business only in Virginia will pay corporate income tax to Virginia at 7.75% (assuming the same corporate income tax rate as North Carolina imposes) and the similar North Carolina corporation doing business only in North Carolina will pay the same corporate income tax to North Carolina. If, however, the shareholders of both corporations are North Carolina residents subject to the North Carolina intangibles tax, the Virginia corporation's shareholders will be taxed and the North Carolina shareholders will not be taxed. Therefore, the aggregate taxation of the shareholder-corporation unit in the United States will increase as stock is held across state lines, even if the price/earnings ratio of the corporation is only 1:1, much less 31:1. This fact illustrates the violation of internal consistency described in Section D below, which the Supreme Court of North Carolina totally ignored.

Furthermore, the North Carolina scheme fails the third requirement for a compensating tax - that the tax must be imposed on a "substantially equivalent event" that produces substantially uniform taxation of intrastate and interstate commerce - even if the threshold issue of the inability of North Carolina to tax corporate income earned out-of-state could be ignored, and if the corporate income and shareholder intangibles taxes were equal (which they are not). *See generally Associated Indus. of Mo. v. Lohman*, 114 S. Ct. 1815. A tax may be considered a compensating tax when "[the] State is attempting to impose a tax on a substantially equivalent event to assure uniform treatment of goods and materials to be consumed in the State." *Maryland v. Louisiana*, 451 U.S. at 759 (rejecting Louisiana's attempt to link a severance tax on gas with a "first use" tax on gas).

The requirement of substantially equivalent events reconfirms the threshold point above, that the compensating tax must compensate for the inability to tax an event the state *has the power to tax*. Without that, the events or tax bases cannot be substantially equivalent.

Furthermore, a shareholder's ownership of stock and a corporation's receipt of income cannot be "substantially equivalent events" in any other sense. The intangibles tax is not paid by the same class of taxpayer as the tax purportedly being compensated for and would not be paid upon the same amount or at the same rate (again, unlike the sales/use tax case).

The two "events" that the Secretary attempts to link are even more unrelated than other linkages this Court has rejected. In *Armco Inc. v. Hardesty*, 467 U.S. 638, this Court addressed the constitutionality of West Virginia's business and occupation tax. There, plaintiff, an Ohio corporation engaged in the business of manufacturing [outside West Virginia] and selling steel products in West Virginia, challenged on Commerce Clause grounds the constitutionality of West Virginia's tax requiring persons engaged in the business of selling tangible property at wholesale to pay taxes on gross receipts. Local manufacturers were exempt from the gross receipts tax;

however, they were required to pay a higher manufacturing tax. This Court found the gross receipts tax unconstitutional, rejecting West Virginia's argument that the higher manufacturing tax was a compensating tax for the gross receipt tax. The Court held:

> [M]anufacturing and wholesaling are not "substantially equivalent events" such that the heavy tax on in-state manufacturers can be said to compensate for the admittedly lighter burden placed on wholesalers from out of State. Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales. The fact that the manufacturing tax is not reduced when a West Virginia manufacturer sells its goods out of State, and that it is reduced when part of the manufacturing takes place out of State, makes clear that the manufacturing tax is just that, and not in part a proxy for the gross receipts tax imposed on Armco and other sellers from other States.

467 U.S. at 643.

D. The North Carolina Tax On Stock Values Fails the Internal Consistency Test, Even If the Intangibles Tax Could be a Compensatory Tax.

1. The North Carolina Supreme Court improperly ignored this Court's requirement that the taxing scheme be internally consistent.

The Supreme Court of North Carolina stopped its analysis with its erroneous decision that *Darnell* controls. This Court, however, requires that an internal consistency test be applied in Commerce Clause cases as a method of identifying discrimination against interstate commerce:

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear.

Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. at 1338. *See also Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. at 159; *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (ruling that facially nondiscriminatory flat taxes on trucks failed the internal consistency test); *Armco Inc. v. Hardesty*, 467 U.S. 638; *Tyler Pipe Indus. v. Wash. Dep't of Revenue*, 483 U.S. 232; *Goldberg v. Sweet*, 488 U.S. 252 (1989); *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916 (stating also that *Armco* extended the internal consistency test doctrine beyond the context in which it had originated) .

When applied to a facially discriminatory tax, the test supplants any requirement that the plaintiff prove the tax had actual discriminatory impact. *See Tyler Pipe Indus. v. Wash. Dep't of Revenue*, 483 U.S. 232, at 240-241 (observing that *Armco* had struck down a tax that actually imposed a heavier burden on local manufacturers), and at 257 (dissent of Scalia); *Jefferson Lines*, 115 S. Ct. at 1338 ("This test asks nothing about the degree of economic reality reflected by the tax . . . .").

This Court addressed the relationship of the compensating tax defense to the internal consistency test in *Armco Inc. v. Hardesty*, 467 U.S. at 642-643 and *Tyler Pipe*, 483 U.S. at 240-247. In both of those cases the Court first identified a facial discrimination, then assessed a compensating tax defense and found it wanting, but went on to find that in any event the taxing scheme was internally inconsistent and thus also invalid for that reason. The fact that one of the taxes to be evaluated under the internal consistency test, the intangible personal property tax, attaches only to a "local" activity (stockholding by residents and business situs stockholding) does not immunize it from Commerce Clause scrutiny. *See generally Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981).

2. Internal consistency is lacking in the North Carolina taxing regime.

Because North Carolina has chosen to link the taxation of shareholders' stock and corporate income, these two taxes necessarily comprise the taxing regime at issue. *Cf. Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. at 1342 n. 6 (1995) (assuming that a gross receipts tax on a seller and a sales tax on a buyer comprise a taxing regime to be evaluated together under the Commerce Clause, when a state's statutes cause the two taxes to be interdependent).

In summary, if all states adopted North Carolina's taxing regime, more tax would be owed when either the corporation enters into interstate commerce or when shareholding crosses state lines away from where the corporation does business.

Increased tax when corporation engages in interstate commerce. For example, suppose Corporation X does business only in North Carolina and so will pay tax there on 100% of its income under the North Carolina income tax. N.C. Gen. Stat. § 105-130.3; App. 1a. Its shareholders will pay no intangibles tax, due to the discriminatory deduction at issue in this case, if they all reside in North Carolina. N.C. Gen. Stat. § 105-203(1); App. 9a. Corporation X will still pay income tax on about 100% of its income under the North Carolina corporate income tax as applied by all states if it enters into interstate commerce and does half of its business in Virginia: about half of its income will be taxed by each of North Carolina and Virginia. In that event, however, its shareholders resident in North Carolina will pay intangibles tax on half of the value of their stock (a proxy for the half of the corporate income that North Carolina cannot constitutionally tax). Thus, Corporation X causes an increase in the aggregate taxation of itself and its shareholders by entering into interstate commerce.

Increased tax when shareholding crosses state lines. Again suppose Corporation X does all of its business in North Carolina and all its shareholders reside there. Corporation X pays tax on 100% of its income and its shareholders pay no intangibles tax. When, however, a shareholder sells his or her stock to a resident of Virginia, that new shareholder will pay Virginia intangibles tax on 100% of stock value, if the North Carolina taxing regime were adopted by all states. Thus, shareholding across state lines from the state where the corporation does its business also causes an increase in aggregate taxation under the North Carolina regime.

The increased taxation caused by interstate elements under the North Carolina tax scheme is directly analogous to that caused when an Ohio manufacturer sold into West Virginia, as described in *Armco Inc. v. Hardesty*, 467 U.S. at 644. It would pay manufacturing tax to Ohio and wholesaling tax to West Virginia while the West Virginia manufacturer selling in West Virginia would only pay the West Virginia manufacturing tax.

North Carolina created this discrimination by attempting to favor local corporations through the deductions at issue here. No discrimination would exist if North Carolina either (a) taxed all of the value of stock owned by its residents (which was the prospective remedy ordered by the North Carolina Court of Appeals in this case), or (b) imposed no tax on stock (which is the remedy by refund sought by Taxpayer and is the prospective "remedy" ordered by the North Carolina General Assembly in repealing the tax for future returns), which would approximate the result of giving a deduction for the percentage of the income of the corporation that is taxed by all states, i.e., 100%.[10]

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[10] The fact that the intangibles and corporate income taxes are imposed on different taxpayers does not change the internal consistency analysis. This Court identified, but expressed no opinion on, a related question in fn. 6 of its opinion in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 115 S. Ct. at 1342, referencing *Darnell v. Indiana*. In the same footnote the Court evaluated the total tax burden on a seller paying gross receipts tax and an *unrelated* buyer paying sales tax. Surely a credit allowed to one taxpayer for tax paid by a *related* taxpayer to State A will be discriminatory if credit is not also allowed for the *related* taxpayer's tax paid to State B. *See S.C. State Hwy. Dep't v. Barnwell Bros.*, 303 U.S. 177, 185 (1938) ("The commerce clause by its own force, prohibits discrimination against interstate commerce, whatever its form or method, ...").

3. *Darnell* also would fail today's internal consistency analysis.

Darnell is factually distinguishable and therefore, the Court need not overrule it to hold for Taxpayer here. As a matter of completeness, however, one must observe that *Darnell* cannot withstand modern internal consistency analysis (just as many older cases could not withstand analysis under *Complete Auto Transit, Inc.*).

The statutory scheme in *Darnell*, if applied by all states, would tax corporations on 100% of their property value in the aggregate nationwide, and would tax shareholders on 100% of their stock value only if the corporation owned no property in the state where the shareholder resided.[11] Thus, shareholding across state lines from where the corporation operates creates the maximum aggregate property tax.

As the value of corporate property owned in the state increases, the taxable value of the shareholders' stock decreases and will reach zero when all of the corporation's property is located in the state where the shareholder resides. Thus, the taxing regime encourages the corporation to "stay at home" and not to do business

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[11] This assumes shareholders of foreign corporations would also be allowed an offset for the value of corporate property owned in the state.

in interstate commerce. The 1912 decision in *Darnell* dealt only elliptically with this issue, relying on analysis in a case brought under the Fourteenth Amendment, which permits multiple taxation.[12]

Within just the last year and a half this Court has twice observed that states cannot ignore taxes paid to other states in Commerce Clause cases. In *Oregon Waste Sys., Inc. v. Dep't of Env. Quality,* 114 S. Ct. 1345, Oregon argued that local companies paid local income taxes that compensated for the special tax on foreign waste. The opinion's footnote 7 observed:

> We would note that respondents, like the dissent, *post*, at 1357, ignore the fact that shippers of waste from other states in all likelihood pay income taxes in other states, a portion of which might well be used to pay for waste reduction activities in those states.

114 S. Ct. at 1353.

Similarly, footnote 6 of *Jefferson Lines, Inc.*, 115 S. Ct. at 1342, states that once a state decides to credit the buyer's sales tax against the seller's gross receipts tax, the state cannot limit that credit to sales tax it collected but must extend the credit to "sales taxes paid to any state."

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[12] *Darnell*, 260 U.S. at 398 (referring to *Kidd v. Alabama*). *See Curry v. McCanless*, 307 U.S. 357 (1939) (ruling that Due Process Clause does not forbid multiple taxation by states). *See also* Pet. 11-12.

Consequently, the *Darnell* taxing regime would not be allowed to stand today (which perhaps is why Indiana has repealed it).

CONCLUSION

The North Carolina intangibles tax on stock paid by Taxpayer violates the Commerce Clause and Taxpayer is entitled at minimum to declaration of that fact and to remand directing the North Carolina Supreme Court to grant a remedy to remove the discrimination. That remedy should be a refund of all tax paid on stock by Taxpayer for 1990.

Respectfully submitted,

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APPENDIX

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N.C. Gen. Stat. § 105-130.3. Corporations.

A tax is imposed on the State net income of every C Corporation doing business in this State at seven and seventy-five one-hundredths percent (7.75%) of the corporation's State net income.

N.C. Gen. Stat. § 105-130.4. Allocation and apportionment of income for corporations.

(a) As used in this section, unless the context otherwise requires:

* * *

(2) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

* * *

(b) A corporation having income from business activity which is taxable both within and without this State shall allocate and apportion its net income or net loss as provided in this section.

* * *

(c) Rents and royalties from real or tangible personal property, gains and losses, interest, dividends less the portion deductible under G.S. 105-130.7, patent and copyright royalties and other kinds of income, to the extent that they constitute nonbusiness income, less

related expenses shall be allocated as provided in subsections (d) through (h) of this section.

(d)(1) Net rents and royalties from real property located in this State are allocable to this State.

(2) Net rents and royalties from tangible personal property are allocable to this State:

a. If and to the extent that the property is utilized in this State, or

b. In their entirety if the corporation's commercial domicile is in this State and the corporation is not organized under the laws of, or is not taxable in, the state in which the property is utilized.

* * *

(e)(1) Gains and losses from sales or other disposition of real property located in this State are allocable to this State.

(2) Gains and losses from sales or other disposition of tangible personal property are allocable to this State if

a. The property had a situs in this State at the time of the sale, or

b. The corporation's commercial domicile is in this State and the corporation is not taxable in the state in which the property has a situs.

(3) Gains and losses from sales or other disposition of intangible personal property are allocable to this State if the corporation's commercial domicile is in this State.

(f) Interest and net dividends are allocable to this State if the corporation's commercial domicile is in this State subject to the following limitations:

* * *

(g)(1) Royalties or similar income received from the use of patents, copyrights, secret processes and other similar intangible property are allocable to this State:

a. If and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in this State, or

b. If and to the extent that the patent, copyright, secret process or other similar intangible property is utilized in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(2) A patent, secret process or other similar intangible property is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, processing, or other use in the state or to the extent that a patented product is produced in the state. If the basis of receipts from such intangible property does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the intangible property is utilized in the state in which the taxpayer's commercial domicile is located.

(3) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of

receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(h) The income less related expenses from any other nonbusiness activities or investments not otherwise specified in this section is allocable to this State if the business situs of the activities or investments are located in this State.

(i) All business income of corporations other than public utilities and excluded corporations shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four. Provided, that where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus one.

(j)(1) The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this State during the income year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the income year.

(2) Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net

annual rental rate. Net annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals except that subrentals shall not be deducted when they constitute business income. Any property under construction and any property the income from which constitutes nonbusiness income shall be excluded in the computation of the property factor.

(3) The average value of property shall be determined by averaging the values at the beginning and end of the income year, but in all cases the Secretary of Revenue may require the averaging of monthly or other periodic values during the income year if reasonably required to reflect properly the average value of the corporation's property. A corporation which ceases its operations in this State before the end of its income year because of its intention to dissolve or to relinquish its certificate of authority, or because of a merger or consolidation, or for any other reason whatsoever shall use the real estate and tangible personal property values as of the first day of the income year and the last day of its operations in this State in determining the average value of property, but the Secretary may require averaging of monthly or other periodic values during the income year if reasonably required to reflect properly the average value of the corporation's property.

(k)(1) The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the income year by the corporation as compensation, and the denominator of which is the total compensation paid everywhere during the income year. All compensation paid to general executive officers and all compensation paid in connection with nonbusiness income shall be excluded in computing the payroll factor. General executive officers shall include the chairman of the board, president, vice-presidents, secretary, treasurer, comptroller, and any other officers serving in similar capacities.

(2) Compensation is paid in this State if:

a. The individual's service is performed entirely within the State; or

b. The individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

c. Some of the service is performed in this State and (i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in this State, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some

part of the service is performed, but the individual's residence is in this State.

(l)(1) The sales factor is a fraction, the numerator of which is the total sales of the corporation in this State during the income year, and the denominator of which is the total sales of the corporation everywhere during the income year. Notwithstanding any other provision under this Division, the receipts from any casual sale of property shall be excluded from both the numerator and the denominator of the sales factor. Where a corporation is not taxable in another state on its business income but is taxable in another state only because of nonbusiness income, all sales shall be treated as having been made in this State.

(2) Sales of tangible personal property are in this State if the property is received in this State by the purchaser. In the case of delivery of goods by common carrier or by other means of transportation, including transportation by the purchaser, the place at which the goods are ultimately received after all transportation has been completed shall be considered as the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person or firm designated by a purchaser from within or without the State shall constitute delivery to the purchaser in this State.

(3) Other sales are in this State if:

a. The receipts are from real or tangible personal property located in this State; or

b. The receipts are from intangible property and are received from sources within this State; or

c. The receipts are from services and the income-producing activities are in this State.

* * *

N.C. Gen. Stat. § 105-130.7. Deductible portion of dividends.

Dividends from stock issued by any corporation shall be deducted to the extent herein provided.

(1) As soon as may be practicable after September 30 of each year, the Secretary of Revenue shall determine from the corporate income tax return filed during the year ending September 30 by each corporation required to file a return during that period the proportion of the entire net income or loss of the corporation allocable to this State under the provisions of G.S. 105-130.4, except as provided herein. If a corporation has a net income in North Carolina and a net loss from all sources wherever located, or if a corporation has a net loss in North Carolina and a net income from all sources wherever located, the Secretary shall require the use of the allocation fraction determined under the provisions of G.S. 105-130.4. A corporation which is a stockholder in any such

corporation shall be allowed to deduct the same proportion of the dividends received by it from such corporation during its income year ending on or after September 30. * * *

N.C.Gen.Stat. § 105-203. Shares of stock.

All shares of stock (including shares and units of ownership of mutual funds, investment trusts, and investment funds) owned by residents of this State or having a business, commercial, or taxable situs in this State on December 31 of each year, with the exceptions herein provided, shall be subject to an annual tax, which is hereby levied, of twenty-five cents (25¢) on every one hundred dollars ($100.00) of the total fair market value of the stock on December 31 of each year less the proportion of the value that is equal to:

(1) In the case of a taxpayer that is a corporation, the proportion of the dividends upon the stock deductible by the taxpayer in computing its income tax liability under G.S. 105-130.7 without regard to the fifteen thousand dollar ($15,000) limitation under G.S. 105-130.7; and

(2) In the case of a taxpayer that is not a corporation, the proportion of the dividends upon the stock that would be deductible by the taxpayer, if the taxpayer were a corporation, in computing its income tax liability under the provisions of G.S. 105-130.7(1), (2), (3), and (3a), without regard to

the fifteen thousand ($15,000) limitation under G.S. 105-130.7.

* * *

[as written for 1990]

N.C. Gen. Stat. § 105-206. When taxes due and payable; date lien attaches; nonresidents; forms for returns; extensions.

All taxes levied in this Article or schedule shall become due and payable on the fifteenth day of April of each year, and the lien of such taxes shall attach annually to all real estate of the taxpayer within this State as of December 31 next preceding the date that such taxes become due and payable, regardless of the time at which liability for the tax may arise or the exact amount thereof be determined; and said lien shall continue until such taxes, with any interest, penalty and costs which shall accrue thereon, shall have been paid.

Every person, firm, association, corporation, clerk of court, guardian, trustee, executor, administrator, receiver, assignee for creditors, trustee in bankruptcy or other fiduciary owning or holding any intangible personal properties defined and classified and/or liable for or required to pay any tax levied in this Article or schedule, either as principal or agent, shall make and deliver to the Secretary of Revenue in such form as he may prescribe in full, accurate and complete return of such tax liability; such return, together with the total amount of tax due, shall be filed on or before the fifteenth day of April in

each year. In case of sickness, absence or other disability or whenever in his judgment good cause exists, the Secretary of Revenue may allow further time for filing returns.

For the purpose of protecting the revenue of this State and to avoid discrimination and prevent evasion of the tax imposed by this Article, every resident or nonresident person, firm, association, trustee or corporation, foreign or domestic, engaged in this State, either as principal or as agent or representative of or on behalf of another, in buying, selling, collecting, discounting, negotiating or otherwise dealing in or handling any of the intangible property defined in this Article, shall be deemed to be doing business in this State for the purpose of this Article, and the principal, superior or person on whose behalf such business is carried on in this State shall likewise be deemed to be doing business in this State, for the purpose of this Article, and where such business is carried on in this State by a corporation, foreign or domestic, it and its parent corporation or the corporation which substantially owns or controls it, by stock ownership or otherwise, shall be deemed to be doing business in this State for the purpose of this Article, and in all such cases the said intangible property acquired in the conduct of such business in this State, and outstanding on December 31 of each year or on any other taxable date, shall be deemed to have a situs in this State and subject to the tax imposed by this Article, notwithstanding any transfer between any of such parties and notwithstanding that the same may be kept or may then be outside of this State, and any of the intangible property defined in this Article and acquired in the conduct of any business carried on in this State, and/or having a business,

commercial or taxable situs in this State, shall be subject to said tax and returned for taxation by the owner thereof or by the agent, person, or corporation in this State employed by such owner to handle or collect the same. Furthermore, the intangible personal property of the estate of any resident of North Carolina shall be deemed to have a taxable situs in this State, and a nonresident administrator or executor of such an estate shall be subject to the requirements of this Article or schedule in the same manner and to the same extent as a resident administrator or executor.

The Secretary of Revenue shall cause to be prepared blank forms for said returns and shall cause them to be distributed throughout the State, and to be furnished upon application; but failure to receive or secure forms shall not relieve any taxpayer from the obligation of making full and complete return of intangible personal properties as provided in this Article or schedule.

N.C. Gen. Stat. § 105-215. Unconstitutionality or invalidity; interpretation; repeal.

If any clause, sentence paragraph or part of this Article or schedule shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Article or schedule, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered. No caption of any section or set of sections

shall in any way affect the interpretation of this Article or any part thereof. All acts and parts of acts inconsistent with the provisions of this Article or schedule are specifically hereby repealed.

N.C. Gen. Stat. § 105-216. Reversion to local units in case of invalidity.

If any clause, sentence, paragraph, or part of this Article or schedule shall for any reason be adjudged by any court of competent jurisdiction to be invalid, and if by virtue of said judgment any one or all of the several taxes classified and levied in this Article or schedule is/are held invalid, then the particular class or classes of intangible personal property affected by said judgment shall become subject to listing, assessment and taxation by the county, municipality, and other taxing jurisdictions in which said intangible personal property has situs in the same manner and at the same rates as applicable to real estate and other tangible properties: Provided, that in such case said listing, assessment and taxation of such intangible personal property by said local taxing units shall become valid and effective as of the tax listing date next preceding March 24, 1939, and shall continue thereafter with full force and effect as if such properties were made taxable by the local taxing unites by direct statutory enactment.

N.C. Gen. Stat. § 105-267. Taxes to be paid; suits for recovery of taxes.

No court of this State shall entertain a suit of any kind brought for the purpose of preventing the collection of any tax imposed in this Subchapter. Whenever a person shall have a valid defense to the enforcement of the collection of a tax assessed or charged against him or his property, such person shall pay such tax to the proper officer, and such payment shall be without prejudice to any defense of rights he may have in the premises. At any time within 30 days after payment, the taxpayer may demand a refund of the tax paid in writing from the Secretary of Revenue and if the same shall not be refunded within 90 days thereafter, may sue the Secretary of Revenue in the courts of the State for the amount so demanded. Such suit may be brought in the Superior Court of Wake County, or in the county in which the taxpayer resides at any time within three years after the expiration of the 90-day period allowed for making the refund. If upon the trial it shall be determined that such a tax or any part thereof was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the same shall be collected as in other cases. The amount of taxes for which judgment shall be rendered in such action shall be refunded by the State; provided, nothing in this section shall be construed to conflict with or supersede the provisions of G.S. 105-241.2.

1995 N.C. Sess. Laws Ch. 41.

Chapter 41 General Assembly of North Carolina 1995 Session Ratified Bill entitled "An Act to Repeal the Intangibles Tax and to Reimburse Local Governments for their Resulting Revenue Loss," ratified April 18, 1995.

The General Assembly of North Carolina enacts:

Section 1.

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(b) Effective January 1, 1995, the remainder of Article 7 [the Intangibles Tax Article] of Chapter 105 of the General Statutes is repealed.

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